

When a national sorority is created and controlled by a business corporation engaged in furnishing services and supplies to the sorority and its member chapters, neither the sorority nor its chapters can qualify for exemption from Federal income tax under section 501(c)(7) or section 501(c)(4) of the Internal Revenue Code of 1954.

Advice has been requested whether a national sorority and its member chapters organized by a business corporation and operated in the manner described below can qualify for exemption from Federal income tax under sections 501(c)(7) or 501(c)(4) of the Internal Revenue Code of 1954.

A business corporation founded a national sorority as a nonprofit organization for the purpose of forming chapters for the study and mutual pursuit of culture and for friendly social contact. The national sorority's constitution provides for an executive council whose powers include fixing national initiation and annual fees, chartering new chapters, and withdrawing of national membership privileges.

The sorority's constitution grants to the founding business corporation the right to select all members of its executive council. As a result the business corporation controls the sorority's governing body.

Under contract with the national sorority, the business corporation provides all supplies and general management, clerical, and administrative services required by the sorority. In consideration for these services, the sorority turns over to the corporation all initiation and annual fees payable to it by the members of its chapters for the privilege of obtaining and continuing membership in the national sorority.

Member chapters of the sorority are organized through the business corporation's efforts. The corporation's field staff recruits the original members, forms them into a chapter, and performs all other services necessary to start the chapter. The national sorority then grants the new chapter a charter as a member of its national organization. The chapter must conform to the national sorority's constitution, rules, and regulations.

Chapter constitution and bylaws are subject to approval by the executive council of the national organization. Furthermore, each new chapter member is required to sign a pledge agreement obligating her to pay a national initiation fee and annual fees directly to the founding business corporation. While the chapters may fix the amounts paid to them as chapter dues they have no control over fixing the amount of fees paid by their members to the business corporation. Failure to pay such fees can result in loss of national membership privileges.

Section 501(c)(7) of the Code provides that clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax provided that no part of the net earnings inures to the benefit of any private shareholder.

Section 501(c)(4) of the Code provides for exemption of organizations not organized for profit but operated exclusively for the promotion of social welfare. An organization may be exempt under section 501(c)(4) of the Code only if it is not organized or operated for profit, and if it is operated exclusively for the promotion of social welfare. See section 1.501(c)(4)-1(a)(1) of the Income Tax Regulations.

The business corporation controls the sorority and member chapters by reason of its control over the national sorority's governing body. The corporation uses this control to carry on a commercial enterprise consisting of furnishing services and supplies to the national sorority, its chapters, and individual members. Collection of national membership fees is enforced by the power of the executive council to withdraw national membership privileges from delinquent members.

Based upon the foregoing, the sorority and its chapters are operated to serve the financial interests of the business corporation. Thus, neither the sorority nor its chapters are organized or operated by members exclusively for pleasure, recreation, and other nonprofitable purposes or for the promotion of social welfare.

Accordingly, the sorority and its member chapters are not exempt from Federal income tax under section 501(c)(7) of the Code as a social club or section 501(c)(4) as a civic or social welfare organization.